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SUBJECT: FRENCH Q-1 GDP INCREASED MUCH LESS THAN EXPECTED

REF: Paris 3352

1. SUMMARY. Disappointing GDP growth in Q-1 (0.8% annualized) means that the GOF target of 2.0 to 2.5% GDP growth in 2005 is almost impossible to achieve. Most economists revised their forecasts downward to levels close to 1.5%. END SUMMARY.

GDP Increases 0.8% (annualized) in Q-1

2. GDP growth (seasonally and workday adjusted) only increased 0.8% (annualized) in the first quarter of 2005, slowing down from 2.8% in 2004 Q-4 (revised downward from 3.6%). The slowdown was mainly due to lower household consumption growth (2.8% annualized versus 4.5% in Q-4). Of note, health spending decreased, probably the first effects of the health insurance reform. Inventories of finished goods also contributed to the slowdown, decreasing in Q-1 as companies preferred getting rid of unsold articles. French performance on the trade front was not good as exports decreased in Q-1 (minus 0.4% annualized), resulting in a negative 0.2% contribution of foreign trade to GDP growth, the first negative contribution since 2000. On a more positive note, corporate investment increased significantly for the second quarter in a row (6.6% annualized), albeit at a lower pace than in Q-4 (7.8%). With the release of Q-1 GDP growth, the French National Statistical Agency INSEE updated its methodology, using the year 2000 as the reference point for the national income accounts (more on this below).

Q-1 GDP Growth Figure is Disappointing

3. The Q-1 GDP growth is far short of the 2.0% (annualized) forecast of many private-sector economists, and even worse than the May 18 Bank of France's governor Christian Noyer's guess that economic growth could slow to 1.6% in Q-1. CCF's economist Nicolas Claquin remarked that "the overall picture for the French economy is rather negative, but corporate investment growth is improving and household consumption is still OK." Before the release of disappointing Q-1 GDP figure, economists forecast low GDP growth in Q-2, and 2005 GDP growth unlikely to be more than 1.5-1.6% (ref). After the release of Q-1 GDP data, some economists (notably Exane economist Emmanuel Ferry) are not totally ruling out a decrease in GDP in Q-2. Goldman Sachs economist Nicolas Sobczak cut his 2005 GDP growth forecast to as low as 1.4% from 1.7%, saying "opponents to the constitution will be at ease to ask: what is the plan for economic growth?"

4. INSEE's Chief forecaster Michel Devilliers admitted that "2005 will not be a good year." Q-2 growth is likely to be low since France, and the euro zone, are affected by three shocks (the euro strength against the US dollar, oil prices, and China's competition). Nonetheless, Devilliers opined that "the French economy keeps its resilience, notably in consumption and corporate investment." According to Devilliers, "fundamentally, the situation is healthy, with inflation under control and low interest rates."

2000 NIA Basis, a Progress for European Harmonization

5. Effective May 20, 2005, the National Agency for Statistical and Economic Studies began using a new national income account reference point, called "the 2000 basis". The switch from the former 1995 basis gave INSEE the opportunity to make three major improvements: adapting GDP data to fit to a better description of the French economy, reevaluating data by using new information sources or information not always available on an annual basis, and using 2000 as a reference year for GDP data taking into account inflation - a change which is required by the

European statistical agency Eurostat.

16. INSEE stressed that new conceptual and methodological changes were necessary to improve the quality of the French national income accounts and to make progress with European harmonization.

17. The switch to the 2000 basis triggered a retrospective revision in GDP data and related aggregates. The 2004 GDP growth was revised downward to 2.3% from 2.4%. GDP growth in the two previous years was revised upward to 1.2% from 1.1% (2002), and to 0.8% from 0.5% (2003).

COMMENT

18. The Q-1 performance is much lower than expected, reinforcing our guess that France growth is well below the GOF's GDP growth forecast of 2.0-2.5% (ref), and well below the pace needed to reduce the government budget deficit below 3.0% of GDP, or reduce the unemployment rate, currently at a five-year high of 10.2%.
WOLFF#